Quick FAQs for Forming a 501(c)(3)

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Many Ethnic Community-Based Organizations (ECBOs) start informally, with a group of people coming together to help newcomer community members meet urgent needs. Typically, new ECBOs have little if any funding to support their work at first; instead, they are fueled in the beginning by passionate leaders and individuals serving as volunteers. But, as an ECBO expands, eventually its leaders arrive at the question: is it time to form a 501(c)(3)?

If your ECBO has reached this turning point—and you are unsure whether or when 501(c)(3) status is right for your organization—this tip sheet is for you. Here, we'll offer insights into what exactly 501(c)(3) status means, what benefits it provides, what steps it requires, and when it's likely the most appropriate option for your ECBO.

Every ECBO can and should make its own choices. Some ECBOs decide to become 501(c)(3)s immediately; others decline even after 10 years of operation. In any case, the information below should help inform your decision-making.

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What does it mean to be a 501(c)(3)?

When a nonprofit organization is recognized by the Internal Revenue Service (IRS) as a tax-exempt organization, we refer to it as a 501(c)(3). For context: section 501(c)(3) of the U.S. Tax Code is the legal basis for giving tax-exempt status to organizations that exist for a *charitable* purpose—that is, to serve the community, advocate for their rights, and enhance their lives and livelihoods. "Tax-exempt" means that an organization does not have to pay taxes on income received from individual donations, grants, or contracts. However, there are some types of income—such as selling goods or services unrelated to your charitable purpose—that even a nonprofit has to pay taxes on. A separate, state-level application is required to receive exemption from state income taxes.

To gain 501(c)(3) status, a nonprofit organization must:

- Exist for the public good—there can be no individual financial benefit.
- Be governed by volunteers—there must be a volunteer Board of Directors.
- Be independent of both the government and private sector—there cannot be control or ownership of the organization by either sector.
- Be non-partisan—the organization cannot support or oppose candidates for elected office.

What are the benefits of being a 501(c)(3)?
The most practical benefit of gaining recognition as a tax-exempt 501(c)(3) organization is that your group gains eligibility to apply for certain grants, contracts, and other contributions to advance your mission that you otherwise would not have been able to as there are some organizations that specifically require this status to apply for funding, for example the Office of Refugee Resettlement (ORR). By law, foundations, corporations, and government entities can only make grants and charitable contributions to organizations with 501(c)(3) status. Likewise, individuals and businesses can claim a tax deduction for their contributions when they give to a recognized 501(c)(3).

There are other benefits as well. When an ECBO is just getting started, the process of applying for 501(c)(3) status can push it to develop essential documents—such as bylaws, conflict of interest policies, preliminary budgets, and fundraising plans. Gaining 501(c)(3) status can also be a sort of "seal of approval" —it lets prospective donors, partners, and community members know that your organization has been vetted and approved by a government agency.

What are the requirements of being a 501(c)(3)?

To maintain 501(c)(3) status, a nonprofit organization must:

- File an annual Form 990 (tax return) with the IRS.
- Ensure compliance with other state and local filings for keeping the organization in good standing.
- Ensure fiscal responsibility by having policies, procedures, and systems for managing your income and expenses. The National Council of Nonprofits provides a wide array of resources for nonprofit financial management.
- Have copies of your Form 990 available for public inspection upon request.

Remember that there is a lot an individual or group can do simply with volunteers and minimal supplies, without needing 501(c)(3) status.

- Keep lobbying to an "insubstantial" amount, which typically means that lobbying must be less than 5% of an organization's activities and/or budget.

How do we know when it's the right time to become an independent 501(c)(3) organization?

Some individuals and groups with a vision for serving the community immediately apply for 501(c)(3) status, often without understanding or preparing for the work required to maintain that status. In deciding whether and when to become a 501(c)(3), groups should first lay out their vision for how they want to serve the community: *What do we want to do? What do we need to* *do? Do we want to develop different programs meeting different needs? Do we want to or need to have paid staff?*

But if it's clear from your vision that you will need significant resources to achieve that vision, and that you expect to run at a large scale for a long time, then it probably makes sense for you to apply for 501(c)(3) status.

What if we are not ready to become an independent 501(c)(3) but want to raise funds to serve and advocate for the community?

One little-known option is to seek out a *fiscal sponsor*—that is, an organization with 501(c)(3) status that helps a project or organization without 501(c)(3) status to operate by receiving and overseeing funds on its behalf. Starting out with a 501(c)(3) as a fiscal sponsor can help startup ECBOs by:

- Allowing you to apply for grants and receive contributions for your work—under the direction of your fiscal sponsor.
- Giving you more time to develop your organization's structure (mission, bylaws, plans, and budgets).
- Providing support and mentoring from an experienced organization before you take on the full responsibility of managing a 501(c)(3).

Most donors, though not all, are familiar with fiscal sponsorship. And most, though again not all, are comfortable making grants through a fiscal sponsor. Here are a few considerations to keep in mind if you choose to work with a fiscal sponsor:

- Find a fiscal sponsor with whom you share a common vision and who values building your startup organization's capacity.
- Remember that the fiscal sponsor will "charge" a percentage of funds raised (usually between 8% and 12%) to manage your funds.
- Consider your timeline for fiscal sponsorship—does your organization want to move toward independence quickly, or would you like to find a fiscal sponsor "home" where you can stay for some time while you build your capacity?

Lastly, in choosing a fiscal sponsor, be aware that there are different kinds of fiscal sponsors. There are organizations whose sole mission and purpose is to serve as fiscal sponsors—often referred to as "professional fiscal sponsors." There are also organizations in the field, typically much larger and with more capacity, who see it as part of their mission to support and mentor emerging organizations.

Remember that there is no one right answer for an emerging ECBO. Each organization needs to make the decision that feels right for them. The purpose of this guide is to help you make an informed choice.

Below, we briefly lay out the key steps for applying for 501(c)(3) status.

What are the steps to becoming a 501(c)(3)?

Step 1: Identify Name, Mission, and Founding Board

To establish a tax-exempt nonprofit organization, the first thing you need to do is to come up with the formal name of the organization and a mission statement that clearly states the purpose of the organization. In most states, you also need to identify at least three founding board members—be sure to check your state's requirements.

Step 2: File Articles of Incorporation

Incorporation is the process by which your organization becomes a legal entity (a nonprofit corporation). ECBOs incorporate by filing at the state level---typically with the office of the Secretary of State or the state Attorney General.

The state agency that registers nonprofit corporations in your state will likely provide template articles of incorporation, which will ask for your mission statement and then provide standard required language.

Note that incorporation at the state level does **not** exempt organizations from federal income tax. An incorporated organization that is not a 501(c)(3) must pay income tax on any funds raised that exceed $5,000 in a year.

Step 3: Get an Employer Identification Number

Even if your organization does not have any employees, you must have a federal employer identification number (EIN). You need an EIN to apply for tax-exempt status from the IRS, and eventually, to open up a bank account in your organization's name.

Step 4: Apply for 501(c)(3) Status

Once you are incorporated and have an EIN number, you can apply for 501(c)(3) status with the IRS. To apply, you must complete Form 1023. You can apply online by registering for an account on Pay.gov, entering "1023" in the search box, and selecting Form 1023. Form 1023 is a lengthy document that will take some time to complete. While you do not need a lawyer to

Remember that gaining 501(c)(3) status will not guarantee that funds suddenly start flowing to the organization. You need to work very hard to build a track record, show success, and fundraise.

complete Form 1023, you might want to ask for help from someone familiar with the form, such as another nonprofit leader or a nonprofit consultant.

What will you need to complete a Form 1023 Application for Tax Exemption?

Your application must include:

1. Bylaws, which set out the general rules for how your organization will be structured, and which must be approved by your board.

2. The articles of incorporation you filed with your state.

3. A brief description of program activities, including:
    a) A description of your *past, present,* and *planned* activities in a narrative.
    b) If applicable, attached copies of newsletters, brochures, or similar documents with details in support of this narrative.

4. A description of compensation and other financial arrangements with your officers, directors, trustees, employees, and independent contractors, including:
    a. The names, titles, and mailing addresses of all of your board members and of the five highest-compensated employees and contractors receiving more than $50,000 per year.
    b. A copy of the conflict-of-interest policy adopted by the board and a brief explanation of how the policy was adopted.

5. A description of the specific services provided to individuals or organizations that receive benefits from your organization, as per the guidance below:
    a. “In carrying out your exempt purposes, do you provide goods, services, or funds to individuals?”—if yes, describe each program that provides them with goods, services, or funds.
    b. “In carrying out your exempt purposes, do you provide goods, services, or funds to organizations?”—if yes, describe each program that provides them with goods, services, or funds.

6. A description of specific additional activities, including:
    a. Any present or future attempts to influence legislation (lobbying), along with a brief explanation of how.
    b. How, specifically, you will raise funds via foundations, individual donors, special events, etc. for “each fundraising program”
    c. A list of the states or jurisdictions in which you will carry out fundraising activities

7. Revenue and expenses from the past three years (see: formatting of Form 1023).

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The decision to form 501(c)(3) involves careful consideration of your organization's mission, objectives, compliance requirements, and long-term sustainability. Evaluating these factors thoroughly will help ensure that the benefits of forming a 501(c)(3) align with your organization’s goals and capacity.